Why ETFs? Why now?

When the first exchange-traded fund (ETF) launched on the Toronto Stock Exchange in 1990, investors had no way of predicting the explosive growth that led to the nearly 8,000 ETFs now available in markets around the world. It was the 30th anniversary of that launch when the Covid-19 crisis struck in March, and while Canadian mutual funds fell into net redemptions, ETFs generated $4.1 billion in net creations. Despite slowing inflows in April as the pandemic reality set in, Canadian-listed ETF assets saw significantly less outflows than mutual funds and even topped the $200 billion milestone that was initially achieved in November 2019.

It's clear that ETF growth has been significant, consistent and robust, so let's dig a little deeper into why. What is it about ETFs that appeals to retail and institutional investors alike?

Below are four of the unique, yet simple, features that draw investors to ETFs. (It's no coincidence that these features also happen to be key drivers of the category's resilience during difficult market environments like the recent COVID-related volatility.)

Portfolio Building | Diversification

An ETF is a basket of investments, whether stocks, bonds, commodities or currencies, that investors can purchase in shares. The basket structure creates natural diversification by spreading the investment across multiple assets within the basket. Because many ETFs track specific indexes, investors can further diversify by incorporating different ETFs based on different indexes to meet the needs of their portfolio. ETFs are an excellent tool for advisors building goals-based strategies for clients because it's easy to diversify in the manner appropriate for each investor's unique needs – asset type, geography, sector, market cap, cost and more.

Performance Value | Cost

Because of the way ETFs are structured and managed, they are typically lower cost as compared to their "basket of investment" cousins, mutual funds. The majority of assets held in ETFs currently on the market passively track an index. This differs from mutual funds that are actively managed by portfolio managers who buy and sell securities in an attempt to beat a predetermined benchmark, rather than track it. While active strategies can play an important role in portfolio building (and many actively managed ETFs have hit the market in recent years), the cost savings offered by passive indexing in combination with the low cost all ETF administration is appealing to investors and can also lead to outperformance because fees can quickly eat into returns.

Precision | Transparency

ETFs trade on an exchange, which means the current price is available in real-time throughout the day. In addition, many ETFs publish holdings daily instead of the monthly or quarterly reporting schedule that most mutual funds follow. This added knowledge can help advisors ensure that the ETF is maintaining the objectives set out in the prospectus and therefore assess at any time if the ETF continues to meet their portfolio needs.

Ease | Liquidity

ETFs are available to buy and sell throughout the trading day. This means investors have the ability to initiate ETF transactions quickly and easily at the current market price. There is typically a trading commission involved, but ETFs provide straightforward access to a wide range of securities because there is no minimum investment and no additional paperwork when an investor chooses to buy or sell.

Continue Growth on the Horizon

In 2018 and 2019, ETFs outsold mutual funds in Canada and in Q1, 2020, Canadian-listed ETFs saw a remarkable $17.1 billion in net creations. While the current pandemic has caused considerable volatility in markets, it has been the same for ETFs as for any other products. "When the market goes down, so do ETFs, there isn't any amplification," says Pat Dunwoody, executive director of the Canadian ETF Association (CETFA). The continued growth of ETFs in retail investor portfolios is showing no signs of slowing.

ETFs have empowered investors and advisers to be able to make asset allocation decisions swiftly and efficiently; to trade in and out of markets when they want, depending on their views. Initially, ETF investments were largely made by institutions; today, ETFs are the investment vehicle of choice for retail investors as well.

Deborah Fuhr, Managing Partner and Founder of ETFGI, an independent global ETF research provider, agrees. "ETFs are uniquely the only democratic investment product being used by institutional investors, financial advisors and retail investors," she wrote in a recent commentary. "Many investors view ETFs as a tool or a solution to assist them in managing their investment management and asset allocation work. New ETFs are being developed to address investor needs for exposure to ESG, thematic, disruptive trends and fixed income."[1]

ETFs can add considerable value to investor portfolios and can help advisors build personalized, goals-based strategies to meet individual client needs effectively and efficiently.

[1] http://www.cetfa.ca/files/1588073925_ETFGI%20News%20Release%20-%2020th%20anniversary%20Europe.pdf